

**Kane County Human Resource
Special Service District
dba Kane County Hospital**

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL**

Table of Contents

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Balance Sheets	6
Revenues, Expenses, and Changes in Net Assets	7
Cash Flows	8
Notes to Financial Statements	10
SUPPLEMENTARY INFORMATION	
Independent Auditor's Report on Supplementary Information	23
Kane County Hospital Auxiliary Fund	24
OTHER REPORTS	
Independent Auditor's Report on State of Utah Legal Compliance	25
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> and Communications with Board of Trustees	27



CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
**Kane County Human Resource
Special Service District
dba Kane County Hospital**
Kanab, Utah

We have audited the accompanying balance sheets of **Kane County Human Resource Special Service District, dba Kane County Hospital**, a Utah Special Service District, as of December 31, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the management of **Kane County Human Resource Special Service District, dba Kane County Hospital**. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Kane County Human Resource Special Service District, dba Kane County Hospital**, as of December 31, 2006 and 2005, and the results of its operations, changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 21, 2007, on our consideration of **Kane County Human Resource Special Service District, dba Kane County Hospital's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. We have also issued our dated May 21, 2007 of **Kane County Human Resource Special Service District, dba Kane County Hospital's** compliance with Utah laws and regulations.

PEOPLE. PRINCIPLES. POSSIBILITIES.

www.eidebailly.com

The management's discussion and analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on management's discussion and analysis.

Eide Bailly LLP

Minneapolis, Minnesota
May 21, 2007

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2006, 2005 AND 2004**

Basic Financial Statements

The basic financial statements include the Balance Sheet, Statements of Revenues, Expenses, and Changes in Net Assets and Statements of Cash Flows. The Balance Sheet is a 'snapshot' of the assets and liabilities of the Special Service District (Hospital) at year-end. It is useful to compare the changes from year to year of the assets available to meet the operational needs and accomplish the mission of the Hospital. The Balance Sheet also shows the liabilities or debt of the Hospital. The liabilities are obligations of the Hospital and offset the value of the assets in the calculation of Net Assets.

The Statements of Revenues, Expenses, and Changes in Net Assets shows both operating and non-operating revenues and expenses. It also explains the change in Net Assets on the Balance Sheet.

Assets

Total Assets increased 3.4% in 2004, 6.3% in 2005, and 8.1% in 2006. Capital Assets; land, buildings, and equipment; decreased 6.5% in 2004, 8.3% in 2005 and increased 2.1% in 2006. There were no significant disposals of assets. The purchase of equipment and property was about \$209,300, \$140,700, and \$675,800 respectively. Purchases were offset by normal depreciation. Noncurrent Cash and Investments decreased 12.1%, 12.1%, then increased 3.2% during the last 3 years. The majority of this change is in an account that holds part of the bond proceeds for equipment purchases and other financial needs of the Special Service District. This account naturally decreases as the funds are used. Most of the 2006 increase is in excess funds set aside for repayment of the bond.

Current assets have increased each year, 45.4%, 43.7% and 20.2%. In the past years increased patient receivables has been the major growth area. In 2006 receivables have been more stable. Cash and inventory have been the significant factors in current assets. The increases in the cost of medicines and the need to stock more medications on hand has caused the inventory increases.

Liabilities

Total Liabilities decreased 4.4%, 25.5% 20.3% in the last 3 years. Payments on total long-term debt, including current maturities, have caused the decrease.

Net Assets

The Net Assets are divided in three parts: 1. Invested in Capital Assets Net of Related Debt; land, buildings, and equipment. Capital Assets are essential to providing services at the Special Service District. They are not liquid and not generally available to meet current obligations of debt; 2. Restricted to Debt Service: These are funds held to make bond payments. A semi-annual payment was just paid prior to year-end. These funds are replenished with Sales Tax revenue and structured so half of the sales tax received is adequate for the payments; 3. Unrestricted Net Assets: This represents the assets available for use in meeting current obligations and operational needs. The overall change in Net Assets is explained in The Statements of Revenues, Expenses, and Changes in Net Assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS -CONTINUED

Operating Revenue

Net Patient Service Revenue increased annually over the last three years, 18.4%, 27.4% and finally 4.9% in 2006. The changes are reflected in the following statistics and show substantial volume increases in 2004 and 2005 and modest increases with some decreases in 2006:

- Patient days increased from 782 to 794 then decreased to 728 in 2006.
- Long-term care days decreased slightly from 8,870 to 9,225 to 9,474.
- Emergency room visits increased from 2,296 to 2,644 to 2,886.
- Surgical cases have decreased from 139 to 131 to 111.
- Total radiological imaging visits increased from 5,131 to 6,106 to 6,321.
- Included in the above are CT Scans from 1,259 to 1,586 to 1,697 and Ultrasound from 505 to 608 to 571.
- Laboratory workload increased 9.5% in 2005 and 6.1% in 2006.

Sales tax revenue increased 12.5% in 2006 compared to an increase of 13.3% in 2005 and 3.7% in 2004.

Operating Expense

Total operating expenses increased 13.5% in 2004, 14.6% in 2005, and 8.8% in 2006. This average annual increase of just over 12% compares favorably with the almost 17% average increase in net patient service revenue. Total wages, benefits, and physician fees increased 11.4%, 13.9%, and finally 8.0% in 2006. These 3 items make up 61.8% of total expenses in 2006 compared with over 63% in the two prior years. Food, drugs, and supplies increased 18.8%, 15.5% and 7.9% in 2006. These items make up just under 14.0% of total expenses.

Non-operating Revenues and Expenses

Non-operating revenues net of non-operating expenses has increased during the last three years. From 2004 to 2005 the increase was \$35,255 in 2006 the increase was \$89,947. The interest expense on the bonds has been reduced as payments are made and the bonds mature. General contributions, mostly the Hospital Auxiliary, and mineral lease funds have had modest increases. Cash/investment funds have increased considerably and the interest on those accounts is more than half of the total increase.

MANAGEMENT'S DISCUSSION AND ANALYSIS -CONTINUED

Overall

The financial statements reflect general improvement in the financial viability of the Special Service District. Patient revenue has increased compared with both the prior two years and the 2006 budget. The expenses have also increased at a lower rate. There are significant opportunities that may improve the reimbursement to the Special Service District. The clinic was converted to a Rural Health Center on January 1, 2005. We are in the process of converting 12 beds to a 'stand-alone' skilled nursing facility. This step is necessary to become a Medicare Critical Access Hospital. The Critical Access Program will bolster Medicare reimbursement to the Special Service District's inpatient and outpatient services.

The area the Special Service District serves, Kane County and northern Arizona, seems to be continuing to grow. The growth offers the opportunity for more efficient utilization of the Hospital resources and a chance to expand to better serve the area outside of Kanab. The District has expanded service in Orderville to improve medical access in the 'valley' communities. We are also seeking other opportunities in our service area.

Contacting the Special Service District's Management

This financial report is designated to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Special Service District's finances and to show the Special Service District's accountability for the money it receives. If you have questions about this report or need additional information, contact either the Administrator's office or the Finance Director's office at Kane County Hospital, 355 North Main, Kanab, UT 84741.

	<u>2006</u>	<u>2005</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 438,627	\$ 422,078
Accounts payable		
Trade	289,379	256,700
Accrued salaries, wages, and benefits	<u>310,212</u>	<u>302,966</u>
Total current liabilities	1,038,218	981,744
 LONG-TERM DEBT, less current maturities	 <u>458,549</u>	 <u>897,176</u>
Total liabilities	<u>1,496,767</u>	<u>1,878,920</u>
 NET ASSETS		
Invested in capital assets net of related debt	3,969,635	3,454,568
Restricted: expandable for debt service	695,010	673,391
Unrestricted	<u>3,785,785</u>	<u>3,194,880</u>
Total net assets	<u>8,450,430</u>	<u>7,322,839</u>
 Total liabilities and net assets	 <u>\$ 9,947,197</u>	 <u>\$ 9,201,759</u>

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES		
Net patient service revenue	\$ 8,079,833	\$ 7,701,115
Sales tax revenue	1,264,947	1,124,552
Other revenue	97,861	77,174
Total operating revenues	<u>9,442,641</u>	<u>8,902,841</u>
OPERATING EXPENSES		
Nursing services	1,067,722	962,868
Other professional services	4,027,742	3,729,959
General services	808,622	743,804
Administrative services	2,127,823	1,906,252
Depreciation and amortization	582,804	577,847
Total operating expenses	<u>8,614,713</u>	<u>7,920,730</u>
OPERATING INCOME	<u>827,928</u>	<u>982,111</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income	72,213	25,251
Interest expense	(49,228)	(74,898)
General contributions	132,607	120,148
Mineral lease revenue	144,071	139,215
Total nonoperating revenues	<u>299,663</u>	<u>209,716</u>
INCREASE IN NET ASSETS	<u>1,127,591</u>	<u>1,191,827</u>
NET ASSETS, BEGINNING OF YEAR	<u>7,322,839</u>	<u>6,131,012</u>
NET ASSETS, END OF YEAR	<u><u>\$ 8,450,430</u></u>	<u><u>\$ 7,322,839</u></u>

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005**

	2006	2005
OPERATING ACTIVITIES		
Receipts from and on behalf of patients	\$ 8,279,235	\$ 7,436,525
Payments to suppliers and contractors	(3,942,594)	(3,446,049)
Payments to employees	(4,147,460)	(4,129,246)
Receipts from sales tax	1,183,854	1,073,805
Other receipts and payments	143,423	23,532
NET CASH FROM OPERATING ACTIVITIES	1,516,458	958,567
NONCAPITAL FINANCING ACTIVITIES		
Mineral lease receipts	141,887	137,524
General contributions	132,607	120,148
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	274,494	257,672
CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(675,793)	(140,714)
Repayment of interest on long-term debt	(49,228)	(74,898)
Repayment of long-term debt	(422,078)	(406,153)
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	(1,147,099)	(621,765)
INVESTING ACTIVITIES		
Interest receipts	72,213	25,251
NET CASH FROM INVESTING ACTIVITIES	72,213	25,251
NET INCREASE IN CASH AND CASH EQUIVALENTS	716,066	619,725
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,790,240	1,170,515
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 2,506,306	\$ 1,790,240
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEETS		
Cash and cash equivalents in current assets	\$ 1,811,296	\$ 1,116,849
Cash and cash equivalents in noncurrent cash and investments	695,010	673,391
Total cash and cash equivalents	\$ 2,506,306	\$ 1,790,240

STATEMENTS OF CASH FLOWS - CONTINUED

	2006	2005
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 827,928	\$ 982,111
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation and amortization	582,804	577,847
Provision for bad debts	1,019,798	541,123
Changes in assets and liabilities		
Receivables	(874,054)	(755,241)
Notes receivable	99,220	20,886
Sales tax receivable	(81,093)	(50,747)
Supplies	(102,937)	(50,811)
Prepaid expenses	4,867	(70,331)
Accounts payable	32,679	(261,730)
Accrued salaries, wages, and benefits	7,246	25,460
NET CASH FROM OPERATING ACTIVITIES	<u>\$ 1,516,458</u>	<u>\$ 958,567</u>

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005**

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Kane County Human Resource Special Service District, dba Kane County Hospital, a Utah Special Service District, (Special Service District), is a special service district established under provisions of Utah Special Service District Act, Chapter 23, Title II, Utah Code Annotated, 1953, as amended, and Article XIV, Section 8 of the Constitution of Utah. The Special Service District is a Hospital licensed for 38 beds. The Special Service District may not issue debt without the approval of Kane County and, for this reason, is considered a component unit of Kane County (Note 4). Being a political subdivision of the State of Utah, the Special Service District is exempt from income taxes. The boundaries of the Special Service District are all real property within the boundaries of Kane County, Utah less and excluding the incorporated areas within the townships of Alton and Big Water.

The Special Service District is governed by a seven member Board of Trustees elected for four-year terms. The Board of Trustees has charge of the administration, maintenance and control of the Special Service District, which consists of a hospital, ambulatory care facility, physician clinic, and an ambulance service.

Also included are the accounts of the Kane County Hospital Auxiliary Fund, whose purpose is to provide financial support to the Special Service District.

Enterprise Fund Accounting

The Special Service District uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Special Service District has adopted the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less, including noncurrent cash and investments.

NOTES TO FINANCIAL STATEMENTS

Notes Receivable

Notes receivable are private pay patient receivables that are separately identified to reflect periodic payments through payment plans approved by the Special Service District. The carrying amount of notes receivable is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Patient Receivables

Patient receivables are uncollateralized customer and third-party payor obligations. Unpaid patient receivables, excluding amounts due from third-party payors, with invoice dates over thirty days old have interest assessed at one percent per month. Due to the uncertainty of collecting private pay accounts, these interest charges are recognized as income when received.

Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Supplies

Supplies are stated at lower of cost (first-in, first-out) or market.

Noncurrent Cash and Investments

Noncurrent cash and investments include restricted expendable assets held by trustees under bond indenture agreements.

Capital Assets

Capital assets acquisitions in excess of \$500 are capitalized and recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these assets lives:

Buildings	8-25 years
Fixed equipment	5-15 years
Movable equipment	2-25 years

NOTES TO FINANCIAL STATEMENTS

Deferred Financing Costs

Deferred financing costs are amortized over the period the related obligation is outstanding using the straight-line method.

Grants and Contributions

From time to time, the Special Service District receives grants from the State of Utah as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized as revenue when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses. Grants receivable are reported in the balance sheet at net realizable value.

Restricted Resources

When the Special Service District has both restricted and unrestricted resources available to finance a particular program, it is the Special Service District's policy to use restricted resources before unrestricted resources.

Net Assets

Net assets are presented in the following three components:

Net Assets Invested in Capital Assets Net of Related Debt - Invested in capital assets net of related debt consist of capital assets, net of accumulated depreciation, unamortized deferred financing costs, and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted Expendable Net Assets - Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditor, grantors, or contributors external to the Special Service District, including amounts deposited as required by revenue bond indenture agreements as discussed in Notes 7 and 9.

Unrestricted Net Assets - Unrestricted net assets are remaining net assets that do not meet the definition of "Invested in Capital Assets Net of Related Debt or Restricted".

NOTES TO FINANCIAL STATEMENTS

Net Patient Service Revenue

The Special Service District has agreements with third-party payors that provide for payments to the Special Service District at amounts different from its established rates. Payment arrangements include prospectively determined rates, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Operating Revenues and Expenses

The Special Service District's statements of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Special Service District's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisitions, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Charity Care

To fulfill its mission of community service, the Special Service District provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Special Service District does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue.

Advertising Costs

The Special Service District expenses advertising costs as they are incurred.

Compensated Absences

The Special Service District's employees earn paid-time off at varying rates depending on years of service. Paid time off does accumulate up to a specified maximum. Employees also earn sick leave benefits. Employees may accumulate sick leave up to a specified maximum. Employees are not paid for accumulated sick leave when they retire or terminate employment.

Investments in Debt and Equity Investments

Investments in debt and equity securities are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenues (expenses) when earned or incurred.

NOTES TO FINANCIAL STATEMENTS

Risk Management

The Special Service District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

NOTE 2 - CHARITY CARE

The Special Service District maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. The amounts of charges foregone, based on established rates, were approximately \$175,000 and \$95,000 for the years ended December 31, 2006 and 2005.

NOTE 3 - NET PATIENT SERVICE REVENUE

The Special Service District has agreements with third-party payors that provide for payments to the Special Service District at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The Special Service District is reimbursed for cost reimbursement items at a tentative rate with final settlement determined after submission of annual cost reports by the Special Service District and audits thereof by the Medicare fiscal intermediary. The Special Service District's Medicare cost reports have been audited by the Medicare fiscal intermediary through the year ended December 31, 2004. The Special Service District's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Special Service District.

The clinic attached to the Special Service District is designated as Certified Provider Based Clinic by the Medicare program. As a result, nonprofessional medical services rendered to Medicare program beneficiaries are reimbursed based on outpatient prospectively determined rates per visit. Professional medical services rendered to Medicare program beneficiaries are reimbursed based on Medicare fee schedules.

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid at a percentage of charges. Inpatient nonacute services (swing beds) related to Medicaid beneficiaries are paid based on prospective per diem rates established by the Medicaid program.

NOTES TO FINANCIAL STATEMENTS

The Special Service District has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to the Special Service District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

A summary of patient service revenue, revenue adjustments, and provision for bad debts for the years ended December 31, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Total patient service revenue	<u>\$ 11,021,789</u>	<u>\$ 9,945,803</u>
Revenue adjustments and provision for bad debts		
Medicare	(1,320,686)	(936,904)
Medicaid	(232,157)	(391,719)
Other	<u>(369,315)</u>	<u>(374,942)</u>
Total revenue adjustments	<u>(1,922,158)</u>	<u>(1,703,565)</u>
Provision for bad debts	<u>(1,019,798)</u>	<u>(541,123)</u>
Total revenue adjustments and provision for bad debts	<u>(2,941,956)</u>	<u>(2,244,688)</u>
Net patient service revenue	<u>\$ 8,079,833</u>	<u>\$ 7,701,115</u>

NOTE 4 - AFFILIATED ORGANIZATIONS

The Special Service District is a component unit of Kane County (County). Effective September 1, 1989, the Special Service District entered into an agreement with the County to assume management, operations, and maintenance of the Special Service District on behalf of the County for the purpose of providing and promoting the delivery of quality health care services for the community served by the Special Service District.

A portion of mineral lease revenue (Note 5) and sales tax revenue (Note 6) were received by the Special Service District during 2006 and 2005 fiscal years through the County.

NOTES TO FINANCIAL STATEMENTS

NOTE 5 - MINERAL LEASE REVENUE

The Special Service District is eligible to receive mineral lease monies from the State of Utah. The mineral lease receivable as noted on the balance sheet totaled \$70,944 and \$68,760 as of December 31, 2006 and 2005, represents monies the Special Service District anticipates receiving for the first half of the State of Utah's fiscal year (July 1 through June 30) which have not been distributed to the Special Service District as of December 31. The mineral lease monies are unrestricted funds. Total mineral lease revenue included in the 2006 and 2005 fiscal years statements of revenues, expenses, and changes in net assets totaled \$144,071 and \$139,215, which consisted of monies received and receivable from the County and Utah's Department of Transportation.

NOTE 6 - SALES TAX REVENUE

During the 1993 general legislative session, the State of Utah legislature passed a law allowing any Utah county legislative body to put to a vote of that county's residents whether the county could impose a local sales and use tax of one percent to fund rural community hospitals in that county. During 1993, the residents living within the boundaries comprising the Special Service District voted upon and passed a resolution to impose a one percent sales and use tax extending through the period ending June 30, 2003. On November 5, 2002, the residents living within the boundaries comprising the Special Service District voted upon and passed a resolution to extend the one percent sales and use tax through the period ending July 1, 2013.

The sales tax receivable as noted on the balance sheet totaled \$313,189 and \$232,096 as of December 31, 2006 and 2005, represents monies collected by the State of Utah prior to December 31, 2006 and 2005, which had not been distributed to the Special Service District. The sales tax monies are unrestricted funds. The sales tax revenue included in the 2006 and 2005 fiscal years statements of revenues, expenses, and changes in net assets totaled \$1,264,947 and \$1,124,552, which consisted of monies received and receivable from the State of Utah and is included in operating revenues.

During the years ended December 31, 2006 and 2005 the Special Service District receipts and uses of the sales tax revenue are summarized below:

	2006	2005
Receipts from sales tax	\$ 1,264,947	\$ 1,124,552
Payments for principal and interest payments on long-term debt	(471,306)	(481,051)
For operating purposes of the Special Service District	(793,641)	(643,501)
Balance of sales tax revenue as of December 31, 2006 and 2005	\$ -	\$ -

NOTES TO FINANCIAL STATEMENTS

NOTE 7 - CASH, INVESTMENTS, AND INVESTMENT INCOME

The Special Service District's cash and noncurrent cash and investments are reported at fair value as discussed in Note 1. Deposits of cash and noncurrent cash and investments as of December 31, 2006 and 2005 are summarized below:

Deposits – Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Special Service District's deposits may not be returned to it. The Special Service District does not have a separate deposit policy for custodial credit risk and follows statutory requirements. The Special Service District had bank balances at December 31, 2006 and 2005 as follows:

	2006	2005
Insured (FDIC)	\$ 166,234	\$ 154,745
Uninsured	842,450	256,368
Insured under bond trustee	316,874	313,581
Deposits with Utah Public Treasurer's Investment Fund	1,304,064	1,153,803
Total Deposits	\$ 2,629,622	\$ 1,878,497
Carrying value on the Balance Sheets	\$ 2,505,656	\$ 1,789,590

The Special Service District follows the requirements of the Utah Money Management Act (Utah Code Annotated 1953, Section 51, Chapter 7) in handling its depository and temporary investment transactions. This law requires the depositing of Government funds in a "qualified depository." The Act defines a "qualified depository" as any financial institution whose deposits are insured by an agency of the federal government and which has been certified by the Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the Utah Money Management Council.

Noncurrent Cash and Investments

The composition of noncurrent cash and investments at December 31, 2006 and 2005, is shown in the following table. Investments are in cash and cash equivalents and are stated at fair value.

	Maturities	2006	2005
Under bond indenture agreement			
Cash and cash equivalents	Daily	\$ 695,010	\$ 673,391

NOTES TO FINANCIAL STATEMENTS

Investments

Deposits with the Utah Public Treasurer's Fund of \$1,304,064 are held in the following percentages as of December 31, 2006:

	<u>2006</u>
Corporate debt	69.20%
Commerical paper and money market	6.67%
Certificates of deposit	7.84%
U.S. Treasuries and U.S. government agency debt	<u>16.29%</u>
	<u>100.00%</u>

Credit Risk

The Utah Money Management Act also defines the types of securities allowed as appropriate temporary investments for Government funds and the conditions for making investment transactions. Investment transactions are to be conducted through qualified depositories or primary reporting dealers.

Interest Rate Risk

The Special Service District investment policy contains a provision that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. At December 31, 2006 the Utah Public Treasurer's Investment Fund has an average adjusted maturity of 69 days. Approximately 37 percent of the securities mature or reprice within 30 days, with 89 percent of the securities maturing or repricing within 90 days.

Investment Income

Investment income and gains and losses on noncurrent cash and investments, cash equivalents, and other investments consists of the following for the years ended December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Nonoperating revenues (expenses)		
Interest income	<u>\$ 72,213</u>	<u>\$ 25,251</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 8 - CAPITAL ASSETS

Capital assets additions, retirements, and balances for the years ended December 31, 2006 and 2005 are as follows:

	Balance December 31, 2005	Additions	Transfers/ Retirements	Balance December 31, 2006
Land	\$ 141,814	\$ 243,900	\$ -	\$ 385,714
Buildings	5,260,016	210,558	181,544	5,652,118
Fixed equipment	11,052	-	-	11,052
Movable equipment	3,957,530	221,335	(181,544)	3,997,321
Totals at historical cost	9,370,412	675,793	-	10,046,205
Less accumulated depreciation for:				
Buildings	1,780,649	216,483	56,391	2,053,523
Fixed equipment	10,185	(1,030)	-	9,155
Movable equipment	2,830,399	359,359	(56,391)	3,133,367
Total accumulated depreciation	4,621,233	574,812	-	5,196,045
Capital assets, net	\$ 4,749,179	\$ 100,981	\$ -	\$ 4,850,160
	Balance December 31, 2004	Additions	Retirements	Balance December 31, 2005
Land	\$ 141,814	\$ -	\$ -	\$ 141,814
Buildings	5,260,016	-	-	5,260,016
Fixed equipment	11,052	-	-	11,052
Movable equipment	3,816,816	140,714	-	3,957,530
Totals at historical cost	9,229,698	140,714	-	9,370,412
Less accumulated depreciation for:				
Buildings	1,565,799	214,850	-	1,780,649
Fixed equipment	8,466	1,719	-	10,185
Movable equipment	2,477,113	353,286	-	2,830,399
Total accumulated depreciation	4,051,378	569,855	-	4,621,233
Capital assets, net	\$ 5,178,320	\$ (429,141)	\$ -	\$ 4,749,179

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

NOTE 9 - LONG-TERM DEBT

Long-term debt consists of the following at December 31, 2006 and 2005:

	Balance December 31, 2005	Additions	Reductions	Balance December 31, 2006	Amounts Due Within One Year
Hospital Sales Tax Revenue and Refunding Bonds, Series 2003	\$ 1,319,254	\$ -	\$ 422,078	\$ 897,176	\$ 438,627
Total long-term debt	\$ 1,319,254	\$ -	\$ 422,078	\$ 897,176	\$ 438,627
	Balance December 31, 2004	Additions	Reductions	Balance December 31, 2005	Amounts Due Within One Year
Hospital Sales Tax Revenue and Refunding Bonds, Series 2003	\$ 1,725,407	\$ -	\$ 406,153	\$ 1,319,254	\$ 422,078
Total long-term debt	\$ 1,725,407	\$ -	\$ 406,153	\$ 1,319,254	\$ 422,078

The Hospital Sales Tax Revenue and Refunding Bonds, Series 2003 bear an interest rate of 3.83 percent and will be repaid at level debt payments to January 1, 2009.

Scheduled principal and interest repayments on long-term debt are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 438,627	\$ 32,373	\$ 471,000
2008	458,549	15,224	473,773
Total	\$ 897,176	\$ 47,597	\$ 944,773

NOTES TO FINANCIAL STATEMENTS

NOTE 10 - RETIREMENT PLAN

The Special Service District has a defined contribution retirement plan for essentially all employees. The Special Service District gives a one percent contribution to all employees and a voluntary matching contribution up to 3 percent of employee contributions. Total retirement plan expense for the years ended December 31, 2006 and 2005 was \$77,428 and \$81,755.

NOTE 11 - CONTINGENCIES

Malpractice Insurance – Health Care Industry

The Special Service District has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1 million per claim and an annual aggregate limit of \$3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

Litigations, Claims, and Other Disputes

The Special Service District is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of litigation, claims, and disputes in process will not be material to the financial position of the Special Service District.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties as well as significant repayments of previously billed and collected revenues from patient services. Management believes the Special Service District is in substantial compliance with current laws and regulations.

NOTES TO FINANCIAL STATEMENTS

NOTE 12 - CONCENTRATION OF CREDIT RISK

The Special Service District grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at December 31, 2006 and 2005 was as follows:

	2006	2005
Medicare	20%	21%
Utah Medicaid	9%	10%
Arizona Medicaid	4%	4%
Blue Cross	6%	5%
Other third-party payors	35%	41%
Patients pay	26%	19%
Total	100%	100%

NOTE 13 - SUBSEQUENT EVENTS

On January 3, 2007, the Special Service District purchased two houses for future expansion. The funds of \$315,000 used to purchase these houses were funded from operations.



CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

The Board of Trustees
Kane County Human Resource
Special Service District
dba Kane County Hospital
Kanab, Utah

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Minneapolis, Minnesota
May 21, 2007

PEOPLE. PRINCIPLES. POSSIBILITIES.

www.eidebailly.com

**KANE COUNTY HUMAN RESOURCE
SPECIAL SERVICE DISTRICT
DBA KANE COUNTY HOSPITAL
KANE COUNTY HOSPITAL AUXILIARY FUND
YEARS ENDED DECEMBER 31, 2006 AND 2005**

Included in these financial statements is the Kane County Hospital Auxiliary Fund (Auxiliary), whose purpose is to provide financial support to the Special Service District. As of December 31, 2006 and 2005, the balance sheets of the Auxiliary are detailed below:

BALANCE SHEETS

December 31,

	<u>2006</u>	<u>2005</u>
ASSETS		
Cash and cash equivalents	\$ 50	\$ 50
Cash and cash equivalents - Securities held at Utah Public Treasurer's Investment Fund	13,146	4,160
Noncurrent cash and investments	62,628	51,746
Thrift Shop - building	174,376	174,376
Thrift Shop - parking lot	41,620	41,620
Thrift Shop - floor covering	3,418	3,418
Accumulated depreciation	(82,461)	(63,704)
Total assets	<u>\$ 212,777</u>	<u>\$ 211,666</u>
UNRESTRICTED NET ASSETS	<u>\$ 212,777</u>	<u>\$ 211,666</u>

The change in noncurrent cash and investments of the Auxiliary for the fiscal years ended December 31, 2006 and 2005, are detailed in the following statements of changes in noncurrent cash and investments:

STATEMENTS OF CHANGES IN NONCURRENT CASH AND INVESTMENTS

Years Ended December 31,

	<u>2006</u>	<u>2005</u>
NONCURRENT CASH AND INVESTMENTS, BEGINNING OF YEAR	<u>\$ 51,746</u>	<u>\$ 76,693</u>
RECEIPTS		
Sales	81,976	78,181
Interest income	792	512
Total receipts	<u>82,768</u>	<u>78,693</u>
DISBURSEMENTS		
Donations to Kane County Hospital	(31,413)	(40,074)
Salaries	(22,855)	(22,441)
Supplies	(2,673)	(7,768)
Utilities	(4,700)	(3,914)
Other	(2,127)	(2,127)
Amounts transferred to the Building Fund	-	(19,500)
Amounts transferred to the Utah Public Treasurer's Investment Fund	(8,118)	(7,816)
Total disbursements	<u>(71,886)</u>	<u>(103,640)</u>
NONCURRENT CASH AND INVESTMENTS, END OF YEAR	<u>\$ 62,628</u>	<u>\$ 51,746</u>



CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT ON STATE OF UTAH LEGAL COMPLIANCE

The Board of Trustees
**Kane County Human Resource
Special Service District**
dba Kane County Hospital
Kanab, Utah

We have audited the accompanying financial statements of **Kane County Human Resource Special Service District, dba Kane County Hospital** (Special Service District), for the year ended December 31, 2006, and have issued our report thereon dated May 21, 2007. As part of our audit, we have audited the Special Service District's compliance with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions applicable to each of its major State assistance programs as required by the *State of Utah Legal Compliance Audit Guide* for the year ended December 31, 2006. The Special Service District received the following major State assistance program from the State of Utah:

Mineral Lease Funds (Department of Transportation) \$144,071

Our audit also included testwork on the Special Service District's compliance with the following general compliance requirements identified in the *State of Utah Legal Compliance Audit Guide*, including:

- Public Debt
- Cash Management
- Purchasing Requirements
- Budgetary Compliance
- Special Districts
- Other General Issues

The management of the Special Service District is responsible for the Special Service District's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the Special Service District's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

PEOPLE. PRINCIPLES. POSSIBILITIES.

www.eidebailly.com

The results of our audit procedures disclosed immaterial instances of noncompliance with requirements referred to above, which are described in the accompanying "Report on Internal Control Over Financial Reporting". We considered these instances of noncompliance in forming an opinion on compliance, which is expressed in the following paragraph.

In our opinion, the **Kane County Human Resource Special Service District, dba Kane County Hospital**, complied, in all material respects, with the general compliance requirements identified above and the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; and special tests and provisions that are applicable to each of its major State assistance programs for the year ended December 31, 2006.

This information is intended solely for the use of the Board of Trustees and management of the Special Service District, Kane County Commissioners, and the State of Utah and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

Minneapolis, Minnesota
May 21, 2007



CPAs & BUSINESS ADVISORS

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS* AND
COMMUNICATIONS WITH BOARD OF TRUSTEES**

The Board of Trustees
**Kane County Human Resource
Special Service District
dba Kane County Hospital
Kanab, Utah**

We have audited the accompanying financial statements of **Kane County Human Resource Special Service District, dba Kane County Hospital** (Special Service District) as of and for the year ended December 31, 2006, and have issued our report thereon dated May 21, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Special Service District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Special Service District's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The significant deficiencies are described in the following sections titled "Current Year Findings," and "Prior Year Findings."

A material weakness is a significant deficiency in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

PEOPLE. PRINCIPLES. POSSIBILITIES.

www.eidebailly.com

Current Year Findings

Exceeding Limit on Personal Time Off

During the audit it was noted that nine employees were over accrued on their personal time off. We recommend the Special Service District follows its policy and encourage employees to take vacations or to amend the policy.

Management Response – Management has reviewed and revised the policy and is following the policy.

Limited Size of Office Staff

Due to the limited number of staff in the business office and accounting departments, certain functions within the departments are not segregated which normally would enhance internal control. However, certain administrative controls are in place, which mitigate the risk of incompatible duties due to employing a limited number to staff.

We recommend the Special Service District continue to review duties and assignments within its operation to ensure appropriate segregation of duties, where possible and strengthen internal control.

Management Response – Management at the Special Service District continues to review the duties and assignments within its operation to ensure appropriate segregation of duties. However, due to the limited number of staff in the business and accounting departments, certain functions cannot be further segregated with would enhance internal control.

Accounting Manual

The Special Service District does not have a complete accounting manual documenting procedures for fiscal operations. A manual should provide the written policies, procedures, and assignments of duties that would provide separation of duties to the extent available, and prevent or reduce misunderstandings, errors, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. It would also ensure that all similar transactions are treated consistently, that accounting principles used are proper, and that records are produced in the form desired by management and the Board of Trustees. In the event of employee turnover, this would provide a means of transition.

We recommend a manual be developed. As procedures are changed, controls can be reviewed or modified which will enhance internal controls.

Management Response – Management will develop a more complete accounting manual. The Special Service District has always strived to be consistent in accounting methods to ensure that the accounting principles are properly implemented.

Journal Entries

Our review of journal entries revealed that not all entries are being approved by someone other than the preparer. We recommend journal entries be approved by someone at a level of authority higher than the preparer. All journal entries should be initialed by both the preparer and the individual approving to document this procedure. We did note all journal entries were accompanied by adequate supporting information and explanations.

We recommend all journal entries be reviewed and approval be documented in writing.

Management Response – Approval of journal entries will be implemented.

Internal Control over the Preparation of the Financial Statements Being Audited

The Special Service District does not have an internal control system designed to provide for the preparation of the financial statements being audited. As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. This circumstance is not unusual in an organization of your size. We were pleased with the internal system of financial statement preparation and the accounting principals and estimates used. The Special Service District, however, does not have personnel up to date in reporting and disclosure requirements under GASB. The Special Service District could gain that knowledge and take over the financial statement preparation. It is the responsibility of management and those charged with governance to make the decision whether to prepare your own financial statements.

Management Response – Management feels that having the auditors draft the financial statements and notes is a tolerable situation. Internal financial statements are prepared monthly for reporting and decision making purposes. Those statements are prepared in a method consistent with generally accepted accounting principles. The requirements and form of the audited statements are different than the internal needs and change occasionally. With the size of our organization, it is helpful to rely on the expertise of the auditors to monitor those requirements.

Purchasing Guidelines-Utah Questionnaire

The *State of Utah Legal Compliance Audit Guide* has detailed requirements for the purchasing policy of the Special Service District. While the Special Service District is following their current policy, it is not in compliance with all of the State requirements such as, to exclude cost plus-a-percentage of cost contracts and include an appeals procedure. We recommend updating the current policy to include all requirements of the State of Utah.

Management Response –

Management will update policy to comply with the State of Utah Legal Compliance Requirements.

Prior Year Findings

Exceeding Limit on Personal Time Off

During the audit it was noted that nine employees were over accrued on their personal time off. We recommend the Special Service District follows its policy and encourage employees to take vacations or to amend the policy.

Management Response – Management of the Special Service District will continue to monitor the personal time off for each employee and will follow the written policy of the Special Service District.

Limited Size of Office Staff

Due to the limited number of staff in the business office and accounting departments, certain functions within the departments are not segregated which normally would enhance internal control. However, certain administrative controls are in place, which mitigate the risk of incompatible duties due to employing a limited number to staff.

We recommend the Special Service District continue to review duties and assignments within its operation to ensure appropriate segregation of duties, where possible and strengthen internal control.

Management Response – Management at the Special Service District continued to review the duties and assignments within its operation to ensure appropriate segregation of duties. However, due to the limited number of staff in the business and accounting departments, certain functions cannot be further segregated with would enhance internal control.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Special Service District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Communications with the Board of Trustees

Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

As stated in our engagement letter dated March 19, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Special Service District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Special Service District's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Other Information in Documents Containing Audited Financial Statements

It is our understanding the Special Service District's financial statements as of and the year ended December 31, 2006 will be included in Kane County's audited financial statements.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Special Service District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year 2006. We noted no transactions entered into by the Special Service District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were estimated net realizable value of patient accounts receivable and notes receivable, and amounts due from/to third-party payors for cost report settlements.

Management's estimate of the collectibility of patient and notes receivables are based on historical trends for uncollectible accounts and contractual adjustments. The estimate of the amounts either owed to or receivable from third-party payors is based on both final and tentatively settled cost reports as well as current year estimates. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes the estimates for all open years are adequate. Any differences between the estimates and the final settlements will be recorded in the period the final settlements are made and will not be treated as prior period adjustments.

We evaluated the key factors and assumptions used to develop the estimates related to the collectibility of patient receivables and notes receivables and the amounts either owed to or receivable from third-party payors in determining the estimates are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Special Service District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Special Service District, either individually or in the aggregate, indicate matters that could have a significant effect on the Special Service District's financial reporting process.

The significant audit adjustments resulting from our audit of the Special Service District's 2006 financial statements are summarized below:

- To adjust depreciation expense to actual - \$55,326
- To record the net assets of the Foundation - \$22,209
- To adjust the estimated settlements from third-party payors - \$55,326

The net effect of our adjustments was to increase net assets by \$115,523.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Special Service District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Special Service District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Other Matters

Days in Patient Accounts Receivable and Notes Receivables

In prior year letters, we recommended the Special Service District implement additional follow-up procedures to promptly bill and collect patient accounts receivable and notes receivable in order to reduce the dollar amount and the number of days revenue outstanding in patient accounts receivable to approximately 65 days.

The following schedule highlights the Special Service District's number of days revenue outstanding in patient accounts receivable and notes receivable and patient accounts receivable as of the last five balance sheet dates:

<u>December 31,</u>	<u>Number of Days Revenue Outstanding - Patient Accounts Receivable and Notes Receivable</u>	<u>Number of Days Revenue Outstanding - Patient Accounts Receivable Only</u>
2006	114	98
2005	110	97
2004	139	115
2003	97	77
2002	89	58

The number of days revenue outstanding in patient accounts receivable and notes receivable as of December 31, 2006 increased four days from the December 31, 2005 days revenue outstanding. We encourage management to continue to strive to reduce the number of days revenue outstanding to industry standards of approximately 65 days.

Reducing the days revenue outstanding for patient accounts receivable from 98 days to 65 days would increase the Special Service District's cash flow by approximately \$500,000.

Capitalization Policy

The policy regarding capitalization of fixed assets is established for any fixed assets greater than \$500. We recommend management consider increasing this limit to anywhere between \$1,000 and \$5,000. Currently the only regulation is for Medicare which has an established limit of \$5,000. Establishing a higher limit would eliminate and remove certain bookkeeping duties in regards to recording and maintaining the detail for fixed assets that are minor in nature and are used on an ongoing basis with shorter useful lives.

Change in Auditing Standards

In May of 2006 the Auditing Standards Board issued Statement of Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS). SAS 112 is moving the current auditing and reporting standards closer to the auditing and reporting standards of public companies. This standard will change and expand the definition of a material weakness resulting in more findings being reported as a material weakness. This standard will also remove the term "reportable condition" and use "significant deficiencies". SAS 112 will define a significant deficiency to include more findings than what a reportable condition would have defined, and was effective for the December 31, 2006 fiscal year.

The definitions used for these terms are as follows:

- A *significant deficiency* is a control, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.
- A *material weakness* is a significant deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.


An example of a significant deficiency in the SAS is a proposed audit adjustment. This means any proposed audit adjustment that we discover will need to be evaluated under the above definitions. Auditors will need to consider how significant the entry is and whether or not there is more than a remote likelihood that this misstatement could occur. For an error to have a less than remote likelihood we would need to have evidence that this is the only time this error occurred and see that this was recorded correctly a significant number of other times. An example that we may be able to say the error has less than a remote likelihood would be if on one bank reconciliation an error was made in one month and we can see that on every other bank reconciliation, and that bank reconciliation for every other month there were not any errors. We would still need to review that error with the dollar amount of the error to determine if there is still a finding that needs to be reported.

In addition, the new SAS requires auditors to report a significant deficiency or material weakness if management or the finance staff is unable to prepare a complete and accurate annual audited financial statements, including required note disclosures.

There are also eight other new auditing standards (number 104 through 111) which will impact how audits are performed and the time required for auditors to complete future audits. The standard setters believe these required new standards result in better audits and are in the public interest.

Conclusion

This information is intended solely for the use of the Board of Trustees and management of the Special Service District, Kane County Commissioners, and the State of Utah and is not intended to be and should not be used by anyone other than these specified parties.


Minneapolis, Minnesota
May 21, 2007